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**ACCESS TO JAPAN'S PHOTOGRAPHIC FILM AND PAPER MARKET:
REPORT ON JAPAN'S IMPLEMENTATION OF ITS
WTO REPRESENTATIONS**

June 9, 1999

This is the second report of the interagency Japan Photographic Film and Paper Monitoring and Enforcement Committee, which was established on February 3, 1998 to review Japan's implementation of the representations it made to the World Trade Organization (WTO) regarding the openness of Japan's market to imports of photographic film and paper.

The Committee's analysis of data and information on the Japanese photographic film and paper market over the past six months indicates that foreign film manufacturers continue to face barriers in the Japanese market and that the Japanese Government needs to take additional steps to improve market access and stimulate greater competition in this sector. While we welcome Japan's response to a number of specific concerns raised by the United States, further significant actions are required by the Japanese Government to ensure that the Japan Fair Trade Commission (JFTC) has sufficient resources to investigate complaints, to address any business practices that unreasonably restrain trade in this sector in line with Japan's representations to the WTO, to open Japan's distribution system to imports, and to prohibit practices that discourage the opening of large stores.

During the September 1998-April 1999 period covered by this report, the Japanese Government has begun developing plans for restructuring the Japanese economy in order to increase productivity and improve Japan's long-term growth prospects. These measures, such as those to upgrade Japan's distribution networks and transportation and information technology infrastructure, may serve to improve business conditions in the Japanese market for domestic and foreign manufacturers alike. Notably absent from these plans, however, are any proposed measures to improve Antimonopoly Law (AML) enforcement and promote robust competition policy. Foreign manufacturers' access to the Japanese market, including the photographic film and paper sector, will continue to be constrained and the economic revitalization that the Japanese Government is seeking through its economic restructuring plans will not be fully realized unless such corresponding measures are implemented.

U.S. Government officials have raised these concerns with their counterparts in recent months and

have strongly urged the Japanese Government to take action to fully open its market and to foster greater competition, including in the photographic film and paper sector. We are determined to continue working to improve market access for U.S. film manufacturers in the Japanese market and will continue to press the Japanese Government in the coming months to take the specific market access and competition policy steps identified in this report.

Sources of Information

This report is based on thorough collection and analysis of information from a variety of sources, including interviews with a number of film wholesalers and retailers and discussions with the JFTC and other Japanese Government agencies. The Committee also reviewed the results of a Kodak-commissioned questionnaire of Japanese retailers in Tokyo, Osaka, Kyoto, and Chiba. Additional data and information were acquired from film manufacturers, Japanese photo industry publications, and other U.S. and Japanese Government and industry sources. The next report, which we expect to release in late 1999, will update the results of the survey of availability of foreign film discussed in the first monitoring report.

Enforcement of the Antimonopoly Law and Promotion of Competition Policy

The Japanese Government represented to the WTO that it actively scrutinizes the film industry to prevent domination of distribution channels by manufacturers, promotes competition, and enforces the AML to prevent suppliers from using business practices that unreasonably restrain trade in the photographic film and paper sector. Although the JFTC has taken some actions to enforce the AML and to enhance transparency in the application of relevant laws in this sector in this reporting period, our analysis shows that the Japanese Government should direct more resources to the JFTC to ensure that it can investigate problematic business practices and actively promote competition in this sector.

In the period covered by this report, the JFTC took two important steps toward addressing specific competition policy concerns raised by the U.S. Government and industry. The JFTC issued a public warning to Japan's Photosensitive Materials Manufacturers Association, which is composed of four Japanese manufacturers of photographic film and paper. Specifically, the JFTC directed the association and its members to cease their exchange of production, sales, and inventory data, which the JFTC found constituted a potential violation of Japan's AML. We urge the JFTC to conduct appropriate follow-up to ensure that the four manufacturers ceased their problematic activities in response to this public warning.

Citing the WTO deliberations on film, the JFTC also implemented specific changes to improve the transparency of its application of the Premiums Law, which should help ensure that the law is not used to restrict retail competition. The JFTC increased the frequency of its reporting from every year to every six months and increased the number of case examples published. We continue to be concerned, however, that informal cautions and instructions relating to the law – which comprise the vast majority of actions taken under this law – often are not publicly available,

making it difficult to assess fully the basis for and extent and nature of Japanese Government actions. In addition to the JFTC's actions, the Fair Trade Promotion Council, a Japanese photographic industry association whose activities were cited in the U.S. Government's WTO case, has indefinitely suspended its activities, citing U.S. Government "legal appeals."

In our first report, we noted that the JFTC appears to be opposing any attempts by the Japanese Photo Retailers Association to restrict price competition in the sale of photo prints and development services. The JFTC appears to be maintaining this stance, which will be critical as Kodak seeks to expand its presence in printing and developing through the increased marketing of "microlabs" in supermarkets, pharmacies, and service stations. (Microlabs are about 30 percent smaller than conventional labs and can be maintained online.) We welcome the JFTC's actions and will continue to monitor this situation closely.

Despite these positive changes, we continue to receive reports of specific instances where problematic business practices are occurring. Specific allegations that have been reported include wholesalers delaying, limiting, or suspending deliveries of Fuji products or services as a form of market control and wholesalers conditioning low wholesale film prices on exclusive sales of Fuji film.

These specific allegations warrant further follow-up by the JFTC. To assist the JFTC's investigative efforts, the Monitoring and Enforcement Committee will strongly encourage companies to report any problematic business practices to the JFTC for possible investigation and enforcement action as warranted, and the U.S. Government will urge the JFTC to take appropriate measures to ensure that those who come forward do not suffer commercial retaliation.

To fully investigate these types of complaints and to eliminate any business practices that unreasonably restrain trade, the Japanese Government should establish a strong competition policy framework as a priority. This framework should provide the JFTC with the resources necessary to actively enforce the AML and advocate competition policy (for example, by the JFTC more widely disseminating the JFTC's Distribution Guidelines and holding seminars for the private sector). The Japanese Government should significantly bolster JFTC resources to investigate allegations of anticompetitive practices, as the United States recommended in its first report last year. In addition, it should undertake active competition policy advocacy efforts, including those agreed to by the Japanese Government in the Second Joint Status Report under the U.S.-Japan Enhanced Initiative on Deregulation and Competition Policy. In the JFY 1999 budget, the JFTC was given only nine additional staff members and only a 2.8-percent increase in its total budget from the previous year. We believe that this allocation will have to be increased considerably if the JFTC is to be able to take the type of proactive enforcement or advocacy efforts required to ensure active competition in the Japanese market generally and in the photographic materials sector in particular.

The Japanese Government also should ensure that the administrative reform that is to be

implemented in January 2001, which currently foresees the JFTC becoming part of a “Ministry of General Affairs,” does not serve to diminish the JFTC’s standing and send the signal that competition policy and its enforcement is a low priority. This will require the Japanese Government to take all necessary measures to maintain the JFTC’s independence, especially regarding personnel and policymaking matters, as Japan agreed under the Enhanced Initiative.

Openness of Distribution System

The Government of Japan represented to the WTO panel that its distribution system is open and that it promotes modernization of the distribution sector by vigorously administering MITI’s Business Practices Guidelines of 1990. These Guidelines provide guidance regarding revisions of business practices such as rebates, transaction conditions, and manufacturers’ suggested retail price to increase the transparency; efficiency; and openness of business operations, including for foreign firms. MITI has taken only very limited action to ensure that its distribution system is open, however, or to ensure that Japanese wholesalers and retailers are familiar with its Business Practices Guidelines. MITI should more actively promote these Guidelines in trade journals and strongly encourage compliance with them.

MITI is planning to conduct a survey on business practices related to distribution in August 1999. This survey will focus on manufacturers and retailers in an effort to improve business practices that may hamper the efficiency of physical distribution. We urge Japan to include wholesalers in the survey and to identify business practices that impede competition as well as efficiency. In addition, the Japanese Government should publicly release the results of this survey and should make public any guidance it issues related to its findings.

MITI also is considering implementing a variety of measures over the next two years to enhance the quality and efficiency of Japan’s distribution system. Among these are steps to establish international distribution centers; to improve roads, airports, and ports; and to reduce regulations regarding trucking and warehousing, which may benefit foreign as well as domestic manufacturers. MITI also is planning government-subsidized measures to build and reinforce links between the manufacturers, wholesalers, and retailers in the supply chain and develop a distribution information network that connects wholesale complexes nationwide. We will monitor the development and implementation of these measures closely to ensure that these linkages do not serve to impede foreign access to the Japanese distribution system as a whole and to the photographic film and paper sector in particular.

Practices Related to Large Retail Stores

The Japanese Government represented to the WTO panel that it prohibits practices that discourage the opening of large stores. Large stores are a key and growing sales channel for foreign firms, including film manufacturers. The first report of the Monitoring and Enforcement Committee stated that the availability of foreign film doubled over the past three years in “non-traditional” outlets, such as supermarkets, department stores, convenience stores, and other non-

photospecialty stores, while the availability of foreign film declined slightly in traditional photospecialty stores.

Overall, the U.S. Government remains concerned with Japanese Government measures that seek to preserve the market power of small- and medium-sized stores over large stores, contrary to its representations to the WTO. These include regulation of the retail sector, subsidies to small- and medium-sized stores, and measures that discourage “excessive” competition in specific sectors, including photographic film. We urge Japan to abandon these policies, which serve to maintain the existing exclusionary distribution structure and to delay the efficiencies that would otherwise occur if the market were allowed to determine the most appropriate structure of the retail sector.

To rationalize and open the distribution sector and allow for the growth of more efficient large stores, the U.S. Government long urged Japan to eliminate the Large-Scale Retail Store Law, including in the WTO film case and under the Enhanced Initiative. In May 1998, the Japanese Government passed legislation that repealed the Large-Scale Retail Store Law, as of June 1, 2000, and enacted a new Large-Scale Retail Store Location Law, which prohibits the use of supply/demand adjustment mechanisms. The Japanese Government is preparing a “Guideline Related to Items That Should Be Taken into Consideration by Persons Who Establish Large-Scale Retail Stores,” which will provide local governments with detailed criteria to serve as a national standard for use in presenting opinions and making recommendations. The Guideline covers noise, parking, traffic, and garbage.

In response to MITI’s solicitation in April 1999 of public comments on the draft Guideline, the U.S. Government provided MITI with extensive comments on May 20. The United States raised concerns that the Guideline, as drafted, could complicate or even discourage new retail store development and create a regulatory environment that is more burdensome than the current regime under the Large-Scale Retail Store Law. Specifically, the United States raised the following concerns with the draft Guideline: (1) the Guideline appears to rely on prior evaluation rather than *ex post* verification, which is contrary to the trend of deregulation in Japan; (2) the Guideline imposes obligations on store openers that exceed current legal requirements and that do not have to be met by existing stores and other types of commercial enterprises; (3) the Guideline uses a number of very vague terms and criteria, which will not provide store openers with the certainty and predictability that they need to undertake orderly plans for establishing and expanding stores, and may lead to disputes between store openers and local governments and local residents; and (4) the Guideline imposes overly-prescriptive standards on store openers that will intrude upon their management prerogatives. In addition, the United States provided specific comments related to noise, parking, and traffic and noted modifications needed in the Guideline. The United States also recommended that fundamental principles underlying implementation of the new Large-Scale Retail Store Location Law, which are contained in a separate Explanatory Document that has no legal status, should be incorporated into the Guideline.

The United States emphasized that if the Public Comment Procedure recently adopted by the Japanese Government is to be effective, it is essential that MITI and the Joint Council of the

Distribution Subcommittee of the Industrial Structure Council and the Distribution Subcommittee of the Small- and Medium-Sized Enterprise Policy Council make the necessary adjustments in the Guideline to respond to the public comments. The United States also emphasized that MITI's use of the Public Comment Procedure would be judged by the extent to which MITI demonstrates serious consideration of the comments received and modifies the final Guideline to address the deficiencies and other problems identified in the comments.

MITI's handling of these comments, however, calls into question the credibility of the public comment process. MITI and its Joint Council finalized the Guideline within 11 days of the closing of the public comment period, despite having received more than 100 detailed comments. More critically, MITI rejected virtually all of the U.S. Government's suggestions for improving the Guideline. As a consequence, the United States is extremely concerned that the new restrictions that the Guideline places on new large-scale retail stores will lead to a more costly and less competitive retail sector in Japan. The U.S. Government has informed the Japanese Government of these concerns at senior levels and of our disappointment with their response to our comments. The United States will continue to press this issue with Japan in the days and weeks ahead and also will closely monitor MITI's development of ministerial ordinances that are required to implement the Large-Scale Retail Store Location Law.

The amended City Planning Law came into effect on November 20, 1998. The amended law allows local governments to create new types of "special-use zones," such as "small-to-medium-sized store zones." The U.S. Government is concerned that local governments will use zoning authority granted to them by the amended law to impose unreasonable restrictions on the location of large retail stores, as occurred under the Large-Scale Retail Store Law. In the Second Joint Status Report under the U.S.-Japan Enhanced Initiative, Japan agreed to require local governments to provide for public review of the proposed special-use designations, hold public hearings, allow interested parties to comment, and require the City Planning Council to conduct an objective and transparent review of comments. The U.S. Government will continue to monitor this issue closely.

U.S. Monitoring Efforts to Continue

The U.S. Government will continue to vigorously monitor Japan's actions in the photographic film and paper market and to press Japan to fully open this sector. We believe U.S. scrutiny has led to some improvements in market access and the conditions of competition in the photographic film and paper sector. Japan needs to take further steps, however, to ensure that its actions are fully in line with its WTO representations. The Monitoring and Enforcement Committee will continue to collect information and data on a regular basis to assess whether Japan is fully implementing measures consistent with its representations to the WTO and to report its results on a semi-annual basis.